

This EMPEA Brief investigates recent developments in African private equity—including the increase in capital raised for the continent during the ‘Africa Rising’ years and subsequent macroeconomic downturn—in order to identify key themes that will play a role in how fund managers navigate rising competition, slower growth and volatility to not only successfully deliver returns for their investors, but also contribute to Africa’s ongoing economic transformation.

A Time for Renewal

Investor optimism toward Africa reached new highs in the early years of this decade. An uninterrupted commodity boom, stable governments and investment in basic infrastructure had fueled sustained economic growth since the turn of the millennium, culminating in the widespread conviction that a new African middle class would be a boon for businesses across the continent for years to come.

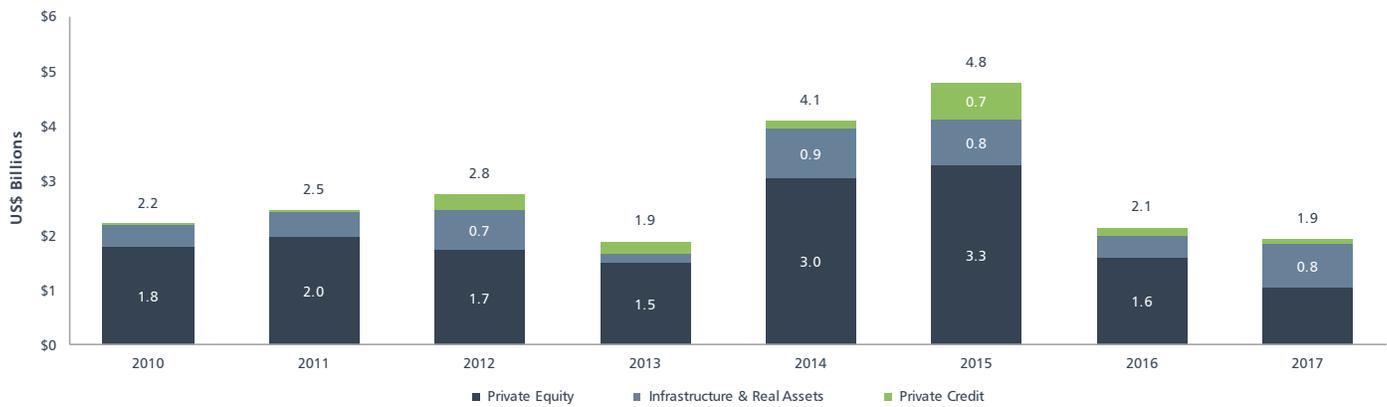
Private equity proved to be a locus of investors’ attention. Over the course of 2014 and 2015, private investment funds focused on Sub-Saharan Africa raised nearly US\$9 billion, and private equity in particular captured US\$6 billion of that total, nearly matching capital raised in the previous four years combined (see Exhibit 1 on the next page). Public pensions, insurers and endowments from the United States and Western Europe entered the African PE space for the first time, joining longstanding development finance institutions (DFIs) in supporting fund managers’ investments in companies that would capture new growth opportunities.

Yet shortly after these commitments were made, many African markets were beset by falling commodity prices, economic slowdowns and currency volatility that has had a knock-on effect on the investment environment

In Summary

- An unprecedented level of fundraising for African private equity in 2014 and 2015, as well as the entry of global players into the market for the first time, has been followed by a period of slower growth and currency volatility in many of the region’s leading economies.
- Although Africa’s near-term economic picture has improved marginally, a bevy of capital raised, especially at the larger end of the market, may also be driving up transaction pricing. At surface level, a dearth of large established businesses in the region appears incongruous with the number of US\$500 million-plus funds that have raised capital in the last few years. However, fewer big incumbents across many industries also means more blank spaces that can be exploited to build national and continental leaders. These structural nuances point to the limitations of a ‘light-touch’ model for PE in Africa.
- Successfully managing investments across all phases of the economic cycle will necessitate turning to new tools for value creation, including operational enhancements driven by deep industry expertise. A ‘hands-on’ approach to managing investments will also mean more intensive use of buy-and-build models as GPs seek to create multi-country platforms that can better withstand economic shocks and attract higher offers at exit.
- Tech-enabled business models across new verticals like e-commerce and distributed power generation are increasingly relevant for investors in the region, especially if such companies can more effectively support the growth of mass consumer markets than traditional small- and medium-sized enterprises (SMEs). While venture capital (VC) players have only recently begun to invest at greater scale in Africa, VC-backed startups hold the potential to alter the competitive dynamics in many industries, as well as generate additional deal flow for larger GPs who can support their growth at a later stage.
- Appetite from strategic buyers for PE-backed companies in Africa has waned as many of the region’s economies have stumbled, meaning longer holding periods for some investments. While traditional funds will continue to be the mainstay for many investors committing to private equity in Africa, in some cases, they may limit GPs’ ability to do the ‘heavy lifting’ necessary to improve businesses or lead them to exit investments prematurely to take advantage of volatile windows of buyer interest. Thus, for some strategies, the time to consider evergreen vehicles as an alternative to fixed-life funds has arrived.

Exhibit 1: Africa Fundraising, 2010-2017



Note: Unless otherwise specified, exhibits include Sub-Saharan Africa and North Africa. In other EMPEA reports and data releases, 'North Africa' may be included in MENA regional totals.

Source: EMPEA. Data as of 31 December 2017.



and return prospects in the region. The continent's largest economies are only now emerging from a protracted period of slow growth (in some cases, actual recession) and policy uncertainty. As a result, many investors are still looking for realized gains at exit—success cases that will attest to the merit of African PE and lend confidence when they are considering their next investments in the region.

EMPEA believes it is crucial to examine these compounding difficulties in order to shine a light on potential paths forward for the asset class. This *Brief* highlights key challenges and opportunities for Africa's private equity players that will play a role in the development of the industry in the years ahead. Above all, recent circumstances illustrate that the private equity model prevailing in Africa must evolve in order to not only better meet the needs of investors, but also play an outsize role in shaping the region's economic future.

About EMPEA

EMPEA is the global industry association for private capital in emerging markets. An independent, non-profit organization, the association brings together 300+ firms—including institutional investors, fund managers and industry advisors—who manage more than US\$5 trillion in assets across 130 countries. EMPEA members share the organization's belief that private capital can deliver attractive long-term investment returns and promote the sustainable growth of companies and economies. EMPEA supports its members globally through authoritative research and intelligence, conferences, networking, education and advocacy.

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The Aftermath of ‘Africa Rising’

At the height of the ‘Africa Rising’ narrative, many investors eyeing opportunities on the continent were taken with not only its recent economic growth record, but also fundamental demographic and structural trends that would bolster returns over the long term. While it is clear that Africa retains immense economic potential, the commodity downturn of the last several years has had a severe impact on recent realized growth. Slower growth and currency volatility have forced many fund managers active in the region to adjust to a less forgiving environment.

Of course, not all economies in the region have been affected to the same degree. Kenya has posted GDP growth just shy of 6% over the last several years, and as a result, East Africa has attracted increasing attention from investors. The continent as a whole remains home to many of the fastest-growing economies globally. However, in 2016, growth in South Africa came to a halt and Nigeria officially entered a recession (see Exhibit 2). These two economies not only are the largest in Africa, but also have historically accounted for the vast majority of private equity activity in the region.

While many Africa-focused GPs have prioritized investments in sectors like health care, education and consumer staples that have grown faster than overall GDP, the broader slowdown in the region’s anchor economies has dovetailed with the depreciation of key currencies (see Exhibit 3). Commodity producers like Nigeria have been among the worst affected, and even countries with relatively robust recent growth figures like Egypt have not been immune from these pressures. Forced to contend with volatile capital flows and depressed prices for raw materials that have squeezed public finances, policymakers have had to make difficult choices. Easing pressure on currencies



through depreciation can serve the region’s economies well in the long run, but for investors in Africa-focused funds, which are typically denominated in U.S. dollars, this process can have a harmful effect on both realized and unrealized returns for certain vintages.

Unless currencies appreciate in the near term, even the best-performing portfolio companies in affected markets will to some extent need to grow their way out of depreciation, which could mean longer holding periods for GPs. Investments exposed to commodity price fluctuations or reliant on discretionary consumer spending may face a longer road to recovery. The result for fund managers, especially those looking to organic growth to drive returns, is a reduced margin for error in deploying capital and harvesting successfully within the constraints of a fixed fund life.

Exhibit 2: GDP Growth Rates for Select African Markets



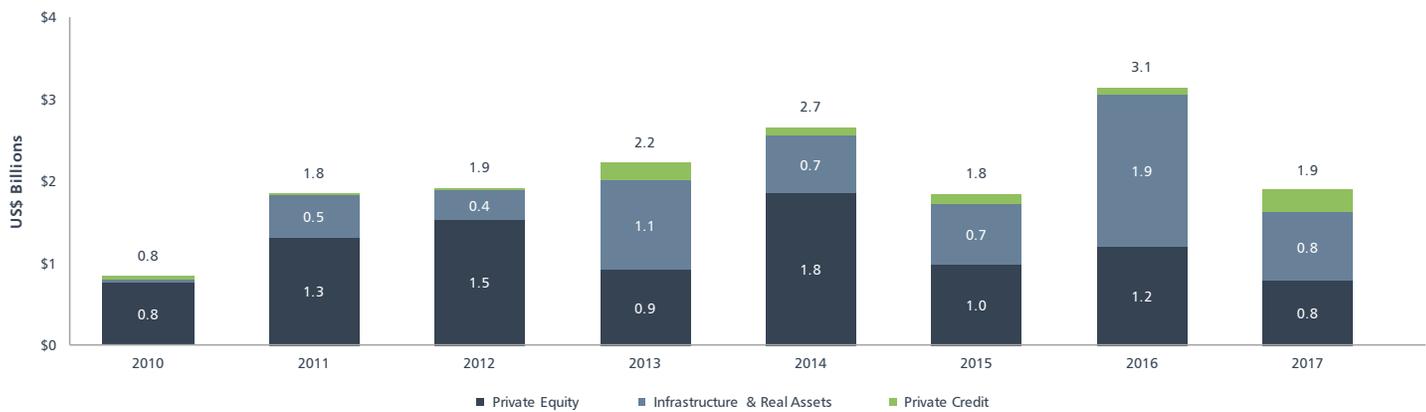
Note: Estimates begin after 2016 for all economies except for Tunisia, for which estimates begin in 2014.
Source: IMF World Economic Database, October 2017.

Exhibit 3: Depreciation Against USD – Select African Currencies



Note: Representative rates for the period 1 January 2013 through 15 March 2018.
Source: Investing.com (accessed 15 March 2018).

Exhibit 4: Africa Investment, 2010-2017



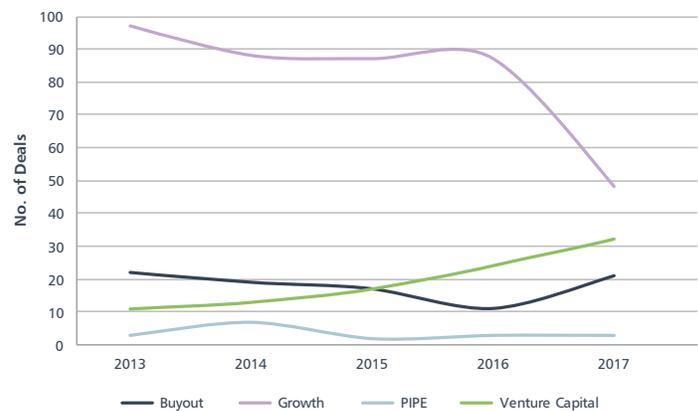
Source: EMPEA. Data as of 31 December 2017.

Investment Activity: Under Pressure

Before the economic cycle turned, private investment activity in Africa had grown for four consecutive years. Disclosed capital invested via all private capital transactions increased from US\$838 million in 2010 to US\$2.7 billion in 2014, and capital invested via PE deals (excluding credit, infrastructure and real assets) reached a post-Global Financial Crisis high at US\$1.8 billion that same year (see Exhibit 4). During this window, longstanding Africa-focused private equity firms were joined in the hunt for deals by newly-formed Africa teams at some of the world’s largest alternative investment managers. The two largest disclosed PE investments from 2014—KKR’s US\$200 million acquisition of Ethiopia-based cut flower producer Afriflora and The Carlyle Group’s US\$147 million PIPE investment in Nigeria’s Diamond Bank—were completed by these new entrants. Moreover, Carlyle closed its first dedicated Africa fund with US\$698 million in commitments in 2014. When coupled with the US\$3.3 billion raised during the same proximate timeframe by Helios Investment Partners, The Abraaj Group, Development Partners International and African Capital Alliance, ample capital was available and being deployed in African PE opportunities. Yet since 2014, PE deal activity has subsided, averaging approximately US\$1 billion annually from 2015 to 2017. While total disclosed capital invested across all deals reached US\$3.1 billion in 2016, most of the increase was driven by investments in infrastructure, particularly grid-scale power generation.

It is difficult to single out any one factor in explaining the decline in overall PE deal activity witnessed in recent years. Slowing growth and resulting financial market volatility across the continent have certainly played a part. Fund managers may be more cautious to commit with currencies in flux and the full ramifications of slowing growth on the performance of individual businesses still unknown. Traditional growth equity deals, in particular, appear to have been affected by this uncertainty. The number of growth PE deals completed in

Exhibit 5: Africa Private Equity Investment by Deal Type, 2013-2017



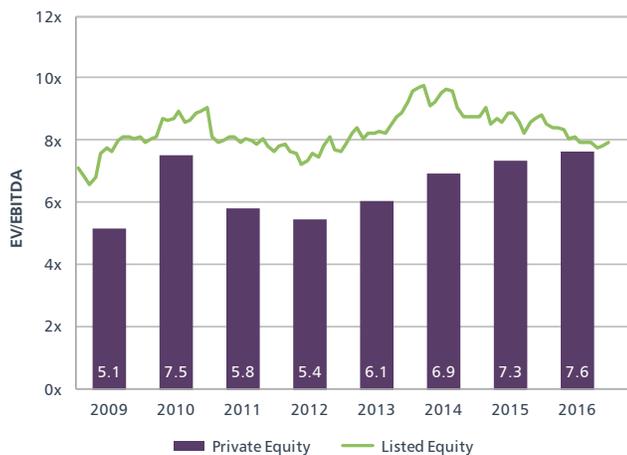
Note: Excludes private credit and private infrastructure and real assets. Source: EMPEA. Data as of 31 December 2017.

Africa fell by 45% from 2016 to 2017, when just 48 such deals were recorded for the continent, the lowest total since 2009 (see Exhibit 5). In contrast, buyouts and venture capital deal activity have proven more resilient, with a record high of 32 VC deals completed in 2017.

The growth equity model has long been the predominant mode of investment across many markets in Africa. Yet it relies on lockstep alignment of interest between a GP and a company’s majority owners and management, as well as a supportive overall economic environment to boost topline revenue growth. Greater unpredictability in the surrounding setting can thus mean a higher degree of difficulty in executing these investments and subsequently managing them effectively. Mounir Guen, CEO of global placement agent Mvision Private Equity Advisers, notes, “Minority investing is very difficult. During the Global Financial Crisis, one of the things that saved private equity in Europe and the United States was the fact that managers had control of the assets. When you have control, you can refinance, you can reposition.”

Data from South Africa-based investment advisor RisCura suggest another factor could also be contributing to a more difficult deal-making environment: more competition. Even as economic prospects across many major African economies have soured, valuations have increased. In 2016, the median EV/EBITDA multiple for PE transactions in the RisCura sample reached 7.6x, a 49% increase from 2009 levels (see Exhibit 6). Rohan Dyer, Partner and Head of Investor Relations at South Africa-focused private equity fund manager Ethos, explains that fund managers have had to exhibit discipline given this dynamic. Beyond Ethos' home market of South Africa, he notes, "In the last two years, there was heavy competition for some of the assets that we looked at. We walked away when the multiples were too heated as we weren't prepared to jeopardize returns."

Exhibit 6: Median EV/EBITDA Multiples for Listed and Private Equity Transactions in Africa

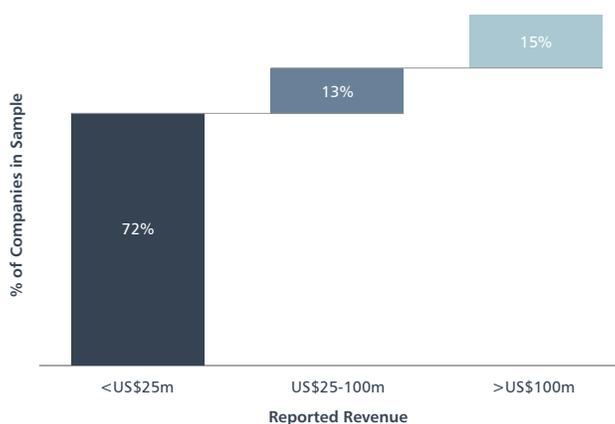


Source: *Bright Africa* (RisCura, S&P Capital IQ). Accessed 26 September 2017.

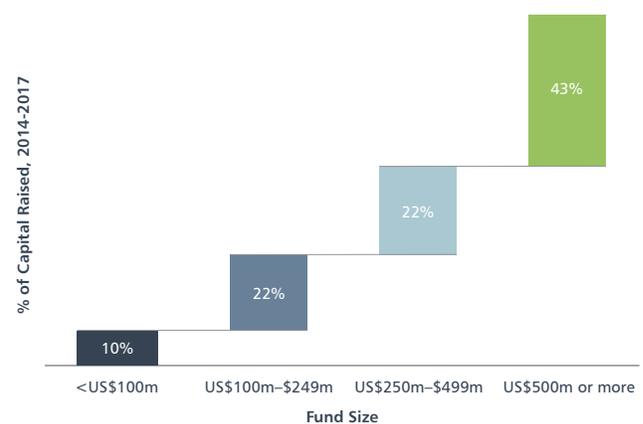
Just ten GPs accounted for 70% of capital raised by Africa-focused funds during the 2014-2015 boom period, and 43% of capital raised from 2014 through 2017 accrued to funds over US\$500 million. Thus, a potential corollary to greater overall competition is that the challenge is particularly acute at the larger end of the deal spectrum given a shortage of suitable targets. According to market research provider Asoko Insight, large established businesses constitute a small fraction of the overall number of private companies operating in some African economies. Across Nigeria, Kenya, Ghana, Ethiopia and Cote d'Ivoire, companies with annual revenues in excess of US\$100 million account for just 15% of all companies in the sample (see Exhibit 7).

David Cook, Partner at pan-emerging markets alternative asset manager Actis, does not observe an overall lack of large-cap deal flow in Africa, but rather a narrower range of conventional targets on offer than perhaps some new entrants expected during the heady days of 'Africa Rising.' He concludes, "New managers and LPs were drawn to the region, with some more experienced than others. Since then, there has been a bifurcation in the market between managers with deep experience in Africa and the ones who saw it as an opportunity and are now struggling to find, execute and exit successful investments. I don't think there is a shortage of deals; sure, this is not a region with consistent flow of US\$250-million deals, but if you're looking for US\$60-million to US\$120-million investment opportunities, there are plenty if you understand and can think creatively around the sectoral themes that are emerging across the continent." Many fund managers and investors active in the region are reaching similar conclusions: if they cannot find ready-made targets with strong exit prospects that can be bought at reasonable valuations—companies of scale with efficiently managed operations and leading positions within their industries—they will need to apply more imaginative approaches to create their own opportunities.

Exhibit 7: Distribution of Private Companies by Revenue vs. Africa-focused PE Fund Sizes



Note: Includes Nigeria, Kenya, Ghana, Ethiopia and Cote d'Ivoire. Source: Asoko Insight (accessed 25 September 2017).



Note: Reported target size used as fund size for funds still seeking commitments. Source: EMPEA. Data as of 31 December 2017.

Themes for the Road Ahead

Regardless of the specific deal size under consideration, fund managers and investors in private equity in Africa recognize more tenuous economic conditions, more volatile currencies and increasingly competitive deal origination as the 'new normal' to which they must adjust. But how?

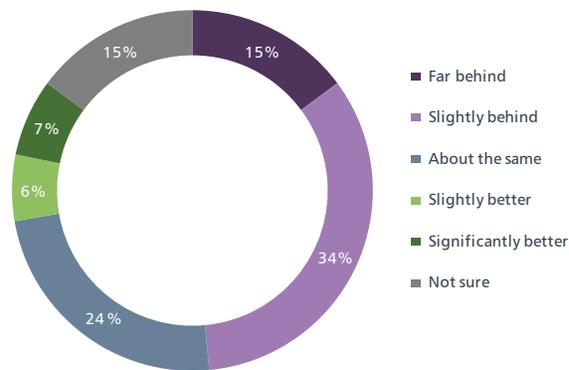
A Renewed Emphasis on Value Creation

According to a representative from a U.S.-based endowment with PE investments in Africa, given the vast array of individual markets in the region—not to mention the persistent gap between these same countries and the world's leading economies in terms of infrastructure, goods and services—it is hard to imagine that the capital raised for African PE funds in the last five years exceeds the scale of the opportunity to invest on the continent. The investor explains, "I don't think competition is an issue. There are really only a handful of large cap players writing checks of US\$75 million or more. That's it—for more than 50 countries." Rather, what may be lacking among some PE teams is the right combination of overall approach and personnel to make truly transformative investments. The investor adds, "The senior team at a GP needs company building know-how. I don't necessarily need to see an operating partner, but I would like a senior team with more than just PE backgrounds because financial engineering in Africa will only take you so far; you have to do a lot of hand-holding and implement organizational transformation at foundational levels, such as upgrading basic accounting systems and building risk management processes."

Evidence from EMPEA's *Global Limited Partners Survey* suggests fund managers in Africa and other emerging markets may still lag behind their peers in developed markets when it comes to the value creation tools at their disposal, at least in the eyes of fund investors. Nearly half of surveyed LPs believe EM PE fund managers' value creation abilities are behind those of their developed market counterparts (see Exhibit 8). Without the ability to pursue alternative value creation initiatives beyond relying on multiple expansion and topline growth, generating the returns investors are looking for will prove to be a challenge for many GPs. In this sense, heightened competition—in turn leading to higher entry multiples and potentially smaller premiums at exit—and slower overall growth will place a premium on managers' ability to build valuable companies in more adverse conditions.¹

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Exhibit 8: EM PE Fund Managers' Value Creation Abilities in Comparison to Developed Market Peers



Source: EMPEA 2018 *Global Limited Partners Survey*.

Naturally, some firms have had more time than others to develop operational value-add approaches by virtue of having invested over many cycles and absorbed the lessons such experiences offer. In describing his own firm's approach, Ethos' Dyer notes, "We try to source opportunities where we can be confident of achieving good returns irrespective of what the economy delivers. Over the past three decades, we have built an institutionalized capability whereby we can be most effective when making investments that have an optimization thesis and/or a consolidation thesis."

For newer GPs, fund size and internal resources may preclude substantial investments in industry experts and operating partners that can be grafted onto existing deal teams. However, without the requisite operational skills and deep sector knowledge necessary to invest and manage wisely across the economic cycle, fund managers and their portfolio companies may prove vulnerable to future shocks. In contrast, many teams exhibit confidence that with the right stewardship and operational approach, even investments made during crises can offer high returns. Actis' Cook explains, "There is a huge preconception that if the macro conditions are negative, then there is no value creation potential. Time and time again, we've seen that is not true. Two of our most successful investments in recent years were made amidst what most people would see as very challenging macro environments." Actis invested in Egypt-based Emerging Markets Payments (EMP) while the country was going through the Arab Spring, and the company reportedly generated an IRR of 27% for its investors when Actis sold it to Network International for US\$340 million in 2016.

1. An important consideration in this debate is whether real operational improvement depends on GPs' majority ownership of (or degree of control over) portfolio companies. For a deeper exploration of this topic, see EMPEA's *Views from the Field: Control Investments in Sub-Saharan Africa* (2017).

“There is a huge preconception that if the macro conditions are negative, then there is no value creation potential. Time and time again, we’ve seen that is not true.”

Creating Regional Leaders

When Actis first established EMP in 2010, it bore little resemblance to the business it is today. The firm employed a strategy increasingly common among some GPs operating in Africa: acquiring businesses in multiple countries through a buy-and-build approach in order to create a broad-based regional platform able to withstand downturns in one or more individual countries and potentially attract a premium offer at exit due to its scale. In the case of EMP, that meant the rollup of Egypt-, Jordan- and South Africa-based businesses into a new entity led by a carefully selected management team. Actis has sought to replicate the model with the launch of Honoris United Universities, a pan-African education business that brings together educational institutions in North and Southern Africa.

Actis is not alone in placing a greater emphasis on regional expansion. Ziad Oueslati, Founding Partner of pan-African private equity fund manager AfricInvest, notes, “Our investment strategy is increasingly evolving toward geographical diversification, which helps mitigate currency risk. Not only do we diversify our portfolio across geographies, but we also invest in companies that can grow regionally. It is really about taking these companies by the hand and bringing them to other markets. One of our portfolio companies, Salvador Caetano Auto Africa, which used to be in two countries, is now present—either directly or indirectly—in 25.” Similarly, Africa-focused private equity and private credit group Amethis Finance recently made the first addition to its health care platform Novamed, acquiring Burkina Faso-based Polyclinique Internationale de Ouagadougou. Novamed, which bought out a group of Cote d’Ivoire-based hospitals at its inception, plans to further expand into West and Central Africa.

The approach can even be enhanced through tie-ups with strategic investors looking to expand their regional footprints—including both developed market-based multinationals and corporate groups native to the continent. In 2017, Africa-focused alternative asset manager Helios Investment Partners partnered with Spanish food company GBfoods to create a pan-African culinary products company. Dabney Tonelli, Investor Relations Partner at Helios, notes, “GBfoods needed a partner to go into African markets they were not already present in, and we partnered with them to



acquire another business and merge it with GBfoods’ African operations.” Tie-ups with strategic investors can have a long gestation period, but they also point to the benefit of a more proactive approach to building a deal pipeline: the opportunity to source transactions outside of auctions. As Tonelli sums it up, “You can’t just be a deal taker, you have to be a deal maker.”

While the platform model is subject to its own challenges and idiosyncrasies, it exemplifies GPs’ ability to find ways to deploy significant amounts of capital, generate value for investors through inorganic growth during difficult stretches and contribute to the modernization of the region’s economic landscape. In essence, with relatively few large, established Africa-based businesses around to absorb US\$100 million-plus checks, private equity players can instead lead the process of building these regional champions.

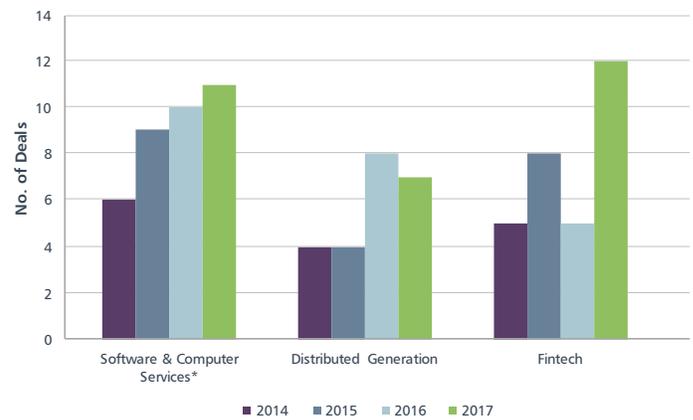
The Rise of Tech-enabled Business Models

In the search for investment opportunities, Africa-focused fund managers also increasingly express conviction in the potential of some of the continent's startups to grow into formidable businesses. The growth potential of companies employing technology-intensive strategies to deliver vital services to a mass market of new consumers has had an impact on their philosophies of how to put capital to work. Helios's Tonelli explains, "Check size is immaterial to us. We think much more about size at exit than size when we come in. We don't need to write US\$100 million checks at the outset, but we have to find businesses that can grow to become market leaders and operate in the largest economies on the continent."

In the largest emerging markets, including China and India, the emergence of new technology platforms offering a broad range of consumer services—from payments and personal finance to ride-hailing and retail—has radically altered the business landscape, and private equity has played a substantial role in funding their growth. While the African technology scene is still in its early days, a similar dynamic could take hold in the region. Tonelli adds, "As a result of technology and innovation, we have the opportunity to invest in businesses that simply could not have existed five or ten years ago. Innovative businesses in distributed power, e-commerce and financial services can come to consume significant amounts of capital." From 2014 through 2017, investments in Africa-based technology companies across segments like software, distributed generation and fintech grew steadily (see Exhibit 9). East Africa in particular, with Nairobi as a regional hub, has attracted a large share of this deal activity.

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Exhibit 9: Africa Investment in New Technology Verticals, 2014-2017



*Excludes companies otherwise classified as 'Fintech'.
Source: EMPEA. Data as of 31 December 2017.

Exhibit 10: Sampling of Africa-focused Venture Capital Funds, 2015-2017

Fund Manager	Fund Name	Geographic Focus	Most Recent Close	Total Capital Raised to Date (US\$m)
Novastar Ventures	Novastar Ventures East Africa Fund I	East Africa	Sep-15	80
Aster Capital	Energy Access Ventures (EAV Africa)*	Sub-Saharan Africa	Feb-15	62
Acumen Capital Partners	KawiSafi Ventures*	East Africa	Aug-17	42
TLcom Capital	TLcom TIDE (Technology and Innovation for Developing Economies) Africa*	Sub-Saharan Africa	Jun-17	40
EchoVC Partners	EchoVC Pan-Africa Fund I	Sub-Saharan Africa	Oct-14	21
4Di Capital	4Di Capital Early-Stage Technology Fund 1*	South Africa	Jun-16	17
Novastar Ventures	FMO Novastar Co-investment Facility	East Africa	May-17	10

*Fundraising as of 31 December 2017.
Source: EMPEA. Data as of 31 December 2017.

Admittedly, larger private equity players will not be able to support new technology startups at the earliest stages of their development. However, a new crop of early-stage venture capital fund managers has emerged to support entrepreneurs across the region (see Exhibit 10). The strategies employed by these GPs represent a departure from conventional notions of VC in developed markets but will be familiar to observers of the tech scenes in Asia and Latin America. Steve Beck, Co-Founder and Managing Director of East Africa-focused Novastar Ventures, describes, “In the Silicon Valley, venture capital-backed businesses are often opening new markets with a new technology and are therefore taking significant market and technology risk. Venture capital, to us, is more about business model innovation, rather than technology innovation. The businesses we back serve a latent demand for basic goods and services, employing proven technologies. Mass low-income markets are already spending money on inefficient off-grid energy, on kerosene and on education. They are just not getting a good bang for their buck. If these more efficient businesses get to scale, we can exit to a strategic buyer who will pay a strategic value for the asset, not a DCF value.”

The growth of technology investing may have unintended consequences. If this new breed of tech-enabled businesses are able to gain traction—as examples from other regions suggest is possible—then family-owned small- and medium-sized businesses (SMEs) may struggle to maintain competitive positioning. Moreover, traditional SME funds, which have long provided growth capital to such enterprises, will face a new challenge to the viability of their strategies going forward. Many observers have already pointed out the constraints of such funds. Novastar’s Beck expands, “I think

the SME space is a tough investment segment. Not only is the upside capped because the businesses will not grow to a size where a strategic buyer will pay a strategic premium, but closely held businesses are reluctant to sell a controlling stake, which a strategic buyer would typically require.” The upshot may be that traditional SME investors increasingly pivot to supporting new companies forged within the technology ecosystem. Regardless, monitoring the growing number of startups employing new technologies to solve the problems of African consumers is vital for investors in Africa who are seeking new ways to put capital to work.

Solving the Exit Puzzle

Even if GPs succeed in finding attractive investment targets and successful ways to create value across their portfolios, exits—or a lack thereof—remain a sticking point for African private equity. EMPEA’s exit data reveal that interest from strategic buyers in PE-backed African businesses has fallen off as the region’s growth narrative has lost some of its luster. Disclosed strategic sales peaked in 2015, when 15 companies were sold to strategic acquirers, before falling to 13 in 2016 and just five in 2017 (see Exhibit 11). These totals likely represent a less-than-comprehensive picture of strategic acquisitions of African assets, given the lack of disclosure across the industry, but they nonetheless have implications for the market: GPs seeking exits via strategic sales are likely at the mercy of the perceived growth prospects of the region. Moreover, as Emmanuel Assiak, Principal at West Africa-focused fund manager African Capital Alliance, explains, “Not only has history shown that it takes longer to exit in Africa compared to more developed markets, but market cycles are getting shorter.”



Exhibit 11: Disclosed Exits in Africa – Select Transaction Types, 2013-2017



Note: ‘Public markets’ includes all IPOs, listings without formal offer of shares and follow-on sales.
Source: EMPEA. Data as of 31 December 2017.

Secondary sales have picked up since 2013, perhaps in large part due to larger fund managers with capital to burn and confidence in their ability to add further value to assets that have previously received backing by GPs. In contrast, public markets have historically accounted for a smaller share of exit activity across Africa than in other EM regions. The data suggest this dynamic is unlikely to change in the near term, and investors with commitments to Africa-focused funds are fully aware of the challenge this poses. A U.S.-based endowment representative notes, “Distributions to date have been very low, which has been frustrating, especially at the larger end because GPs are so dependent on capital markets (think IPOs or large debt issuances) where macroeconomic turmoil can shut exit windows for long periods of time. The GPs are then sitting on large assets that they have to sell to a strategic business since there is no real secondary plate of big private equity firms to take them on just yet.”

As EMPEA has identified in previous reports, without additional distributions, fund managers not only in Africa, but across emerging markets are unlikely to demonstrate the track records necessary to earn follow-on commitments. The result will be longer, less successful fundraising cycles and a protracted unwinding of older investments, with GPs unable to move quickly to pursue new attractive opportunities. For the endowment representative, solving the exit puzzle can be partially addressed by firms keeping the exit in mind at the outset: “I think the structuring element is overlooked. Many GPs are inclined to throw common equity into companies and call it a day. Smart GPs are the ones who learned from their mistakes over the cycle and refined their approach. Such managers will make wise use of tools such as preferred equity and U.S.-dollar return thresholds to ensure seniority in

“I think the structuring element is overlooked. Many GPs are inclined to throw common equity into companies and call it a day. Smart GPs are the ones who learned from their mistakes over the cycle and refined their approach.”

terms of distributions and, ultimately, liquidity. Structuring along with pricing discipline upon entry are key to surviving the cycles.”

Perhaps even more than wobbly growth or perceived competitive pressures, the slow exit pace to date helps to explain some LPs’ wariness over current prospects for private equity in Africa. Yet fund managers in turn take solace in the fact that they have challenged old precedents before and succeeded. Dabney Tonelli of Helios explains, “Investors are skeptical about Africa. Their skepticism is completely rational until they see evidence to the contrary. For example, we invested US\$178 million in Equity Bank for a 25% stake in 2007. We exited in a combination of transactions to investors, including Norfund and Norfinance, local pension funds and international institutional investors. Until you saw that happen, you absolutely had the right to doubt we could sell such a large holding, which was also a minority stake, in a Kenya-based bank.”



A Place for Permanent capital

Fund managers' confidence in their ability to generate distributions for investors will likely be put to the test in the near term. Improved economic conditions and the end to protracted periods of political dysfunction in key African markets have reignited portfolio flows into African securities and increased hopes that high-profile public offerings for some of the largest PE-controlled assets will follow.

However, not all GPs will be able to find timely exits for portfolio companies. In some cases, this may result from the lasting effects of the growth downturn and currency adjustments on the performance of certain assets. In others, fund managers may believe that too quick an exit will limit their ability to realize the full potential of a given company. Whatever the reason, a growing number of GPs are raising longer-dated or evergreen funds in response to the constraints imposed by the traditional fund model, and leading investors on the African continent are increasingly supportive of these efforts (see Exhibit 12).



Exhibit 12: Sampling of Africa-focused Permanent Capital Vehicles, 2014-2017

Fund Manager	Fund Name(s)	Geographic Focus	Most Recent Close	Total Capital Raised to Date (US\$m)	Additional Notes
Acorn Private Equity	Acorn Agri	Southern Africa	Jun-16	64	Evergreen investment fund targeting agricultural and food businesses
AfricInvest	Financial Inclusion Vehicle (FIVE)	Pan-Africa	Dec-17	N/A	FMO and BIO committed EUR20m and EUR10m, respectively
Amethis Finance	Amethis Finance Fund	Pan-Africa	Jun-14	333	Traditional fixed-life fund with option to convert to evergreen fund
Capitalworks Group	Africa Capitalworks (ACW)	Pan-Africa	Oct-17	40	CDC provided US\$40m commitment; Public Investment Corporation also invested
Investisseurs & Partenaires (I&P)	Sinergi Niger, Sinergi Burkina Faso, Teranga Capital, Comoe Capital, Miarakap	West Africa, Madagascar	N/A	N/A	Country-specific evergreen funds focused on SMEs
Solon Capital Partners	Solon Capital Holdings	Sierra Leone	Aug-17	20	Aims to provide interim liquidity through dividends and exits at the holding company level; CDC provided US\$20m commitment
Tana Africa Investment Managers	Tana Africa Capital II	Pan-Africa	N/A	303	Captive joint venture between E. Oppenheimer & Son and Temasek Holdings; fund operates as an evergreen investment company

Source: EMPEA. Data as of 31 December 2017.



A ten-year fund life does not always offer enough time to nurture relationships with founders, source deals, deploy capital, grow assets and exit. Difficulties with limited fund terms are especially pronounced in industries where assets take time to grow, with financial institutions as a case in point. Pan-African fund manager AfricInvest had these factors in mind when it launched FIVE, an evergreen platform for investing in financial institutions in Africa. AfricInvest Director Ann Wyman weighs in: “One of the reasons AfricInvest formed FIVE as a permanent capital vehicle is that the typical PE holding period may not be sufficient to implement innovative strategies growing Tier-Two or Tier-Three financial institutions in the banking, insurance or leasing sectors.” In developing the platform, the firm has grappled with one of the central challenges of evergreen funds: providing liquidity for investors. She adds, “The vehicle’s structuring is unique, and we hope it will eventually inspire the industry. That said, it will take time for permanent capital vehicles to prove themselves—perhaps five to seven years. You can promise liquidity, but you need to provide it in order to turn skeptical investors into believers.”

Equally important is the ability of permanent capital vehicles to provide access to investors that may be interested in the private equity opportunity but discouraged by the illiquid fixed-life fund model. In 2016, Ethos listed a permanent capital vehicle on the Johannesburg Stock Exchange. Ethos Capital, as the fund is known, will in turn provide exposure to the firm’s traditional closed-end vehicles. Rohan Dyer explains the rationale: “Launching Ethos Capital was about broadening our sources of capital and seeding our new fund strategies with a significant commitment, which is important as we expand our product offering.” The strategy has been successful in attracting South African investors and points to a potential path forward for getting additional local capital committed to the asset class. MVision’s Mounir Guen adds, “GPs are not tapping into local capital as much as they could be. It is critical to allow smart local capital to help develop the region.” Alternative fundraising models may be the best means of fulfilling this aspiration.

Outlook

While this *Brief* has attempted to highlight key themes and trends that will shape the PE landscape in Africa in the years to come, industry debates over the right strategies to employ or sweet spots to exploit must be placed in context. The size and diversity of the continent, as well as the depths of its needs, provide ample opportunity for African private equity to grow in many shapes and varieties. As Runa Alam, Co-Founding Partner and CEO of pan-African private equity firm Development Partners International, notes, “In Africa, there is a lot of capacity for every sort of fund. The percentage of private equity capital versus GDP is very low. Every market is underserved.”

Ambitious entrepreneurs motivated to improve their countries and creative GPs who do not bow in the face of adversity can together foster an even better landscape for private investment in years to come. MVision’s Guen explains, “The region is energetic and has talent, but it has a small headcount. When investors look at the choices they have, they are quite limited. You can fit the whole private equity community on a bus. There are some beautiful stories, like the telecom towers. But how many of these are there? How can they be impactful when there are so few? Africa needs to see more of that.”

For Africa-focused private equity players to have an even greater impact on the region’s story, more capital will be needed. Yet DPI’s Alam concludes that LPs will be scrutinizing return track records with an eye to identifying the teams who are best placed to succeed. She notes, “In general, private equity returns in Africa are fairly average, but the top-quartile funds are outperforming even the listed-market indices. LPs who are concerned with allocating to top-quartile funds examine team execution capabilities.” Greater commitments on the part of investors will only arrive when previous bets pay off on a grander scale, and those GPs who differentiate themselves through their execution capabilities will naturally attract LP capital. This crucial ability to execute and to adapt quickly to changing circumstances will separate firms with the staying power to mold and shape Africa’s private businesses long into the future. ●●